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No. 91-615

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1991

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,
Petitioner,
v.
DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

Brief Amicus Curiae of Multistate Tax Commission in Support of Respondent on Reargument

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QUESTIONS PRESENTED ON REARGUMENT

1. Should the Court overrule *Asarco* v. *Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co.* v. *Taxation & Revenue Department*, 458 U.S. 354 (1982)?

2. If *Asarco* and *Woolworth* were overruled, should the decision apply retroactively?

3. If *Asarco* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in the several states?

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BRIEF AMICUS CURIAE OF MULTISTATE TAX COMMISSION IN SUPPORT OF RESPONDENT ON REARGUMENT

INTEREST OF AMICUS CURIAE

Amicus will not repeat its previous statement. Br. *Am. Cr.* Multistate Tax Comm'n 1-3. *Amicus* will supplement its statement in light of the Court's announced willingness to revisit the fundamentals of apportioning intangible income in nondomiciliary States.

Amicus believes the unitary business principle critically supports state taxation of multijurisdictional commerce. Nonetheless, confusion has imparted a

quasi-elective quality to the principle for taxpayers under our voluntary, self-assessment system. Additionally, the field experience of States indicates it is difficult, though not absolutely impossible, for states to resist successfully taxpayers desiring to secure unitary or combined treatment for the different segments of their enterprises. These practical realities influence how *Amicus* reacts to proposals for a workable concept of a unitary business. *Amicus* seeks a practical, even-handed statement of the unitary business principle.

SUMMARY OF ARGUMENT

ASARCO and *Woolworth* should be overruled. Three indefensible concepts adversely impacting the unitary business principle are derived from these cases: (i) the view that a unitary relationship between the taxpayer-owner and the issuer of an intangible is essential to support the apportionability of intangible income; (ii) the endorsement of a narrow view of a unitary business within a nondomiciliary State; and (iii) notion that "the potentials of the relationship" will not support a finding of a unitary business. These mistaken concepts may have emanated from an unfounded suspicion and an inadequate record that reflected the realities of state tax litigation involving multinational enterprises. By identifying the state tax system that the Court is upholding with respect to nondomiciliary state taxation of intangible income, the Court will insure against making similar mistakes here.

In the absence of impermissible discrimination, the Constitution permits nondomiciliary states flexibility in dividing the income of multijurisdictional business where the result is not unfair or arbitrary. New Jersey may retain its single entity form of taxation (as a statutorily defined unitary business concept) as long as it is applied logically and consistently. Other States may retain combined reporting and distinct business reporting. In these latter States, a unitary business is indicated by the existence of management organized or poised to referee the activities of its different business segments to ensure operations for the betterment of the integrated whole of the enterprise.

Overruling of *ASARCO* and *Woolworth* should be retroactive, because overruling would not establish a new principle of law or deny taxpayers equity.

ARGUMENT

I. *ASARCO* AND *WOOLWORTH* SHOULD BE OVERRULED, BECAUSE THEY CONTAIN AT LEAST THREE ERRONEOUS CONCEPTS, WERE POSSIBLY UNFAIRLY INFLUENCED BY AN UNFOUNDED SUSPICION AND AN INADEQUATE RECORD, AND FAILED TO IDENTIFY A WORKABLE STATE TAX SYSTEM WITH RESPECT TO THE APPORTIONMENT OF INTANGIBLE INCOME.

A. *The Court Erroneously (i) Used Language Suggesting An Exclusive Test For Determining The Apportionability Of Intangible Income; (ii) Endorsed Too Narrow A View Of A Unitary Business; and (iii) Disregarded The Probative Value Of Establishing "The Potentials Of The Relationship" Among Affiliated Business Segments.*

At least three concepts derivative of *ASARCO Inc.* v. *Idaho State Tax Comm'n*, 458 U.S. 307, *reh. denied*, 459 U.S. 961 (1982), and *F.W. Woolworth Co.* v. *Taxation & Revenue Dept.*, 458 U.S. 354, *reh. denied*, 459 U.S. 961 (1982), have unjustifiably poisoned the evolutionary waters of the unitary business principle: (i) the view that the *exclusive* test for determining the apportionability of intangible income in a nondomiciliary State is the presence of a unitary relationship between the operations of the taxpayer and the operations of the issuer of the intangible, *ASARCO, supra*, 458 U.S. at 325, 327; (ii) the endorsement of a narrow view of the scope of a unitary business that is conducted within a nondomiciliary taxing State, *ASARCO, supra*, 458 U.S. at 322 (Idaho silver mining insufficiently connected to Southern Peru's autonomous business); and (iii) the notion that a unitary relationship cannot be established by reference to "the potentials of the relationship" among affiliated business segments. *Woolworth, supra*, 458 U.S. at 363.

Mobil Oil Corp. v. *Comm'r of Taxes of Vermont*, 445 U.S. 425 (1980), did not adopt the concept that appor-

tionability of intangible income in a nondomiciliary State is dependent upon the existence of a unitary relationship between the owner-taxpayer and the issuer of the intangible. *Mobil Oil, supra,* 445 U.S. at 442. Notwithstanding Allied-Signal's invocation of this shibboleth of the multinational corporations, Pet. Br. 23-24, no serious student of state taxation believes the Court really intended to adopt such an absolute rule. *See e.g.*, J. Hellerstein, STATE TAXATION: CORPORATE INCOME AND FRANCHISE TAXES ¶ 9.12[2] p. 551 (1983); W. Hellerstein, *State Income Taxation of Multijurisdictional Corporations and the Supreme Court*, 35 NAT'L TAX J. 401, 416 *ff.* (1982); *but see Unitary Business Defined*, 4:8 MULTISTATE TAX ANALYST (Oct. 1989). The Court has indicated parenthetically that it never intended the concept to be exclusive. *ASARCO, supra,* 458 U.S. at 307 n.21; *Container Corp. of America* v. *Franchise Tax Bd.*, 463 U.S. 159, 180 n.19, *reh. denied*, 464 U.S. 909 (1983).[1]

Rejecting the exclusivity of the concept is consistent with the Court's application of the unitary business principle. Identification of the scope of a business enterprise whose income has sufficient connection to the taxing State to be subject to apportionment is dependent upon whether the disputed

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[1]Some state courts will not evaluate the extraneous statements occurring in *ASARCO* and *Woolworth*. State courts in the esoteric realm of applying the unitary business principle as a constitutional limit on state taxation are often literalists. *Corning Glass Works, Inc.* v. *Virginia Dept. of Taxation*, 241 Va. 353, 402 S.E. 2d 35 (1991), *cert. denied*, 112 S.Ct. 277 (1991); *James* v. *Internat'l Telephone & Telegraph Corp.*, 654 S.W.2d 865 (Mo. Banc 1983).

income arose from the same unitary business being conducted in the taxing State. *Container Corp., supra,* 463 U.S. at 166. The examination does not require the presence of a *direct* relationship between the operational activities giving rise to the disputed income and the operational activities occurring within the taxing State. It is sufficient to satisfy fundamental fairness that both sets of activities, otherwise not *directly* related, are nonetheless related by virtue of their occurring within the same unitary business. *See Amerada Hess Corp.* v. *New Jersey Dept. of Treasury,* 490 U.S. 66, 73-74 (1989) (oil producing activities occurring outside of taxing State related to taxing State by virtue of this activity being conducted by a unitary business).

Equally destructive of the unitary business principle is the Court's narrow view of the scope of a unitary business being conducted within a nondomiciliary, taxing State. This narrow view was manifested by the Court's statement that no unitary connection had been established between the Idaho silver mining business and Southern Peru's autonomous [copper] business. *ASARCO, supra,* 458 U.S. at 322. The narrow view was influenced by the Court's then current understanding that "a continuous flow and interchange of common products" were essential to finding a unitary business. *ASARCO, supra,* 458 U.S. at 329-30 n.24. Thus, the Court in *ASARCO* mistakenly concentrated on *directly* connecting the activities occurring within the taxing State to the intangible asset. The Court's error was not to determine first whether holding of the intangible

asset and the activities occurring within the taxing State, both seemingly distinct, were otherwise integrated into the whole of ASARCO, or into a unitary business. The Court's improper narrow view also carried over to the Court's overreaction to the corporate business purpose test.[2]

Fundamentally, the Court proceeded from an incorrect premise in *ASARCO*. A unitary business is defined, not by the specific activities that are occurring within the taxing State, but by the scope of the business that is being operated as an *integrated whole*. Since *Adams Express Co.* v. *Ohio*, 165 U.S. 194, 222 (1897), the focus of the Court has been on a unity of use and management that results in integration of the segments of the enterprise that otherwise are claimed to be separate and distinct. *Butler Bros.* v. *McColgan*, 315 U.S. 501, 508 (1942); *Container Corp., supra*, 463 U.S. at 179. The telltale sign of a unitary business is the sharing or exchange of value not capable of precise *identification* or *measurement*. *Id.*, 463 U.S. at 166. The sharing or exchange of value is present, or at least has the potential to be present, when the management of the enterprise is organized or poised to ensure that different business

[2]State tax administrators do not believe the Court understood Idaho's argument. *ASARCO, supra*, 458 U.S. at 325-27. Idaho argued that if the ownership of an intangible is in furtherance, or an integral part, of the corporate purpose *of the unitary business being conducted in the taxing State*, then the intangible income is apportionable. *Amici* California *et al.* nicely rephrase the proper expression of the corporate purpose test as the unitary purpose test. Cal. *et al. Am. Br.* Rearg. 20-21.

segments operate cooperatively for the betterment of the whole and not individually without regard to the interest of the whole. A continuous flow and interchange of common products is not required.[3] *Container Corp.*, *supra*, 463 U.S. at 178 n.17.

Allied-Signal's beauty shop/parking lot example, Tr. Oral Arg. 8-9, can be used to demonstrate the fallacy of defining a unitary business narrowly by examining for a *direct* relationship between the operational activities occurring within the taxing State and the operational activities giving rise to the intangible income. Assume with respect to the example that the shift in business focus to the parking lot operation was based upon the informed judgment of management that a better rate of return could be achieved by California parking lots than New Jersey and New York beauty shops. Assume further, however, that if capital improvements were made to the New Jersey and New York beauty shops (say renovation of the ambiance from a worn out 60's motif to a 90's modern music motif), the return of the beauty shops would substantially improve.

These assumptions that seem realistic and may even bear some resemblance to what occurred in this case suggest that the shift in business focus would result in a subordination of the beauty shops' specific

[3]Neither is the scope of a unitary business defined by the capacity of separate accounting to source income accurately. *Butler Bros.* v. *McColgan*, 315 U.S. 501 (1942). If the enterprise is unitary, separate accounting by definition is inherently imprecise. *Exxon Corp.* v. *Dept. of Revenue of Wisconsin*, 447 U.S. 207 (1980).

interest in favor of the new parking lots. The subordination would occur for the greater good of the integrated whole of the enterprise. This kind of subordination necessarily creates a transfer of value not capable of precise identification or measurement.

One valid way to describe the expanded example that reveals the transfer of value is to note that in effect the beauty shop operation in New Jersey and New York has made a constructive loan to the parking lot operation in California for which it will receive no compensation. This transfer, while not having *federal* tax significance, because the federal tax code operates nationally without restriction as to the boundaries of the States, has tremendous *state* tax significance. Without deviating substantially from federal tax conformity by attempting to account separately for these kind of imputed transactions within a single corporation or an affiliated group of corporations, the States are left with developing a pragmatic solution. Determining the extent of apportionable income by reference to the existence of management that is organized or poised to ensure that individual business segments operate for the benefit of the integrated whole of the business enterprise provides the practical answer. The parking lot income is properly attributable to the states in which the beauty shops are located but only by reference to the apportionment factors of the entire business enterprise present in the taxing State. This result is fair, because these factors, after all, will have in a real sense supported the acquisition of the parking lots.

The only rejoinder the Court appears to have to this argument is its characterization of the intangible income in *ASARCO* as arising from a passive investment. *Container Corp.*, 463 U.S. 177 n.15. Yet the identification of taxpayer's ownership of intangible property as a "passive investment" states only a *conclusion* that the income generated by the intangible is not apportionable (at least under the domiciliary tax system apparently being upheld in *ASARCO*). *Cf. Mobil Oil, supra,* 445 U.S. at 445. A proper *method of analysis* for determining whether the ownership of a particular intangible is a so-called "passive investment" is to ascertain whether *the ownership* of the intangible is connected in the due process sense to the integrated whole of the business enterprise, part of which is being conducted in the taxing State.[4]

The required determination cannot be made without *first* identifying the scope of business activities that are within the integrated whole, or the unitary business, of the enterprise. *Container Corp., supra,* 463 U.S. at 169. Identification of individual, operational activities occurring within the several States does not indicate whether these separate activities are integrated through management that referees among the segments of the enterprise for the betterment of the whole. To determine the

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[4]It would still be a proper due process test to ask whether the issuer of the intangible was in a unitary relationship with the owner-taxpayer. But this inquiry should not be the *exclusive* method of constitutional analysis for determining the apportionability of intangible income.

existence of a unitary relationship simply by reference to the operating activities without asking whether those operating activities fit into the integrated whole of the enterprise is to fail to define the scope of the unitary business. The dissent in *ASARCO* was correct in *first* identifying the unitary business, part of which was conducted within Idaho, as "nonferrous metals" and tying thereafter that unitary nonferrous metals business to ASARCO's ownership of the corporate stock of companies related to that very industry. *ASARCO, supra,* 458 U.S. at 340-44. (O'Connor, J., dissenting).

The third erroneous notion that crept into the unitary business jurisprudence from *ASARCO* and *Woolworth* was the Court's position that a unitary relationship cannot be established by reference to "the potentials of the relationship" between the entities that are being examined. *Woolworth, supra,* 458 U.S. at 363. Accordingly, the Court dismissed the existence of occasional oversight in capital structure, major debt, and dividends, as non-operational stewardship activities. *Id.,* 458 U.S. at 369. Additionally, the Court was impressed by the absence of formal managerial ties, *id.*, and the absence of a continuous flow and interchange of common products. *ASARCO, supra,* 458 U.S. at 329-30 n.24.

The fundamental reason that the Court's rejection of the "potentials" as a sufficient basis for supporting a finding of a unitary business cannot stand is that the complaining taxpayer always has the burden of establishing the absence of a unitary relationship, *i.e.*, the

presence of extra-territorial taxation, by "clear and cogent evidence." *Container Corp., supra,* 463 U.S. at 164. The burden must unequivocally remain on the taxpayer, because the examination after all seeks to discover a sharing or exchange of value *not capable of precise identification or measurement. Id.*, 463 U.S. at 166. Proof of the existence of the potential for control will suggest possible "implicit control" sufficient to result in an integrated enterprise.[5] *Id.*, 463 U.S. at 177 n.16.

Preservation of the well established burden of proof doctrine with regard to the unitary business principle is critically important to effective state tax administration. Each State in the typical unitary case is taxing only a small slice of the income includible in the preapportionment tax base. There are few cases where the State, as populated as New Jersey or as sparsely settled as Montana, can realistically be expected to propound 237 interrogatories with subparts, take 10 depositions and make document requests. Tr. Oral Arg. 32. It is unrealistic to expect each State to have to delve into *all* the particulars of the relationship between *all* the separate business segments of a multijurisdictional enterprise to identify the specific factual predicates that will support a unitary business finding. This kind of unrealistic examination is uncalled for

[5]Achievement of a level of integration that will support unitary treatment is not dependent upon the proof of actual communication within management that dictates results. Effective management operates by defining what is expected and then allowing the subordinate managers to achieve those objectives "voluntarily."

when the taxpayer's organization discloses a grouping of business segments that seek to achieve "factors of profitability" from the operation of the business as a whole. *Mobil Oil, supra,* 445 U.S. at 438.

B. *The Results In* ASARCO *And* Woolworth *May Have Been Unfairly Influenced By An Unfounded Suspicion Of The States' Motives And By An Inadequate Record.*

The Court's opinion in *ASARCO* carries a curious undertone regarding a perception that Idaho inconsistently identified the companies includible in the combined group. *ASARCO, supra,* 458 U.S. at 326 n.22. The apparent implication is that Idaho's *inclusion* of certain companies that resulted in the disregard of any dividends as apportionable income and Idaho's *exclusion* of other companies that resulted in the potential inclusion of dividends was revenue driven. *See ASARCO, supra,* 458 U.S. at 312 and 312 n.8 (*wholly* owned subsidiaries whose dividends because of federal tax code conformity would be excluded from the preapportionment base in any event were combined; subsidiaries of under 80% were not combined in some States, including Idaho, because of the problem such ownership would present, citing n. 12 of *Mobil Oil, supra,* 445 U.S. at 435 (federal tax code conformity preserves 15% of dividends of companies owned less than 80% for inclusion in the preapportionment tax base)).

Whether the Court had an unspoken concern about the State's true motives in determining the extent of the combined group, Idaho's actual litigation strategy in *ASARCO* was not revenue driven. Idaho's strategy was to preserve the purity of the combined group, thereby facilitating possible *state* court approval of the use of combined reporting in its first formal test case of that concept. Idaho's concentration in *ASARCO* was directed to defending the selection of the companies it included within the combined group, not to the selection of the companies it excluded. The State did not devote substantial attention to developing a record to support the resulting apportionability of the dividend income that was attributable to the excluded companies. In addition, the small attention the State gave to developing a record on the apportionability of intangible income was accomplished without the State having the benefit of Court's opinions in *Mobil Oil, supra,* and *Exxon Corp.* v. *Dept. of Revenue of Wisconsin,* 447 U.S. 207 (1980).[6]

The State's litigation strategy paid off, because the trial court's decision upholding combined reporting in Idaho was not appealed. *ASARCO, supra,* 458 U.S. at 314. It is not surprising given this reality of the *ASARCO* litigation that the record would not affirmatively reflect in detail how the *ownership* of the

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[6]*American Smelting & Refining Co.* v. *Idaho State Tax Comm'n,* 99 Idaho 924, 592 P.2d 32 (1979), predates both *Mobil Oil* and *Exxon Corp.*

excluded companies related to ASARCO's unitary business. The absence of a fully developed record was fatal to Idaho, because the Court placed so much emphasis on the necessity for affirmative facts and findings.[7] The implausibility of the conclusion reached in *ASARCO* confirms the lack of attention that was given to the record. It simply is not realistic to believe that a publicly held, multinational company whose financial results are directly affected by its ownership interests would have both a totally "hands-off" approach and a passive investment mentality with respect to companies operating within its own industry.

Woolworth reflects a similar reality of litigation. The total New Mexico assessment (which involved other revenue matters, including interest) was $16,478. J.A. in No. 80-1745, p. 67a. As a sparsely settled State with a relatively small economy, it is not surprising that New Mexico limited its efforts. The challenge a *State* faces to develop a "full" record to support a unitary finding with respect to a resistant multinational company which controls the facts and whose relevant records are spread out over the world cannot be overstated. After all, the

[7]*Container Corp., supra,* 463 U.S. at 176-77 n.15 and 179 n. 18; *ASARCO, supra,* 458 U.S. at 322 (findings and undisputed facts), 325 n.21 (dissent's perception of facts differs; trial court's findings noted; dissent's description at odds with undisputed facts), 327 n.22 (facts differ), and 329 n. 24 (cases decided on facts). The same observations pertain to *Woolworth, supra,* 458 U.S. at 360 (Court notes poor record developed), 362 (dividend *in fact* derived from unrelated business enterprise), 364-69 (review of the facts) and 369 (conclusion reached on basis of undisputed facts).

Internal Revenue Service needs extraordinary provisions to deal with international commerce. *See e.g.*, 26 U.S.C.A. §6038A (West Supp. 1992).

These observations are particularly pertinent because the Court has announced a willingness to reexamine the system of taxation that should govern the division of income of intangible income in nondomiciliary states. If the Court's real concern in *ASARCO* was the inconsistency of application of the unitary business principle, then the Court should focus on developing a statement of the unitary business principle that is clear, reasonably administrable and even-handed. Certainly a State employing combined reporting should not be permitted to exclude business segments arbitrarily from the unitary business to achieve a better revenue effect. But requiring a "logically consistent" unitary business concept is something far less than the adoption of the unrealistic and restrictive standard suggested by *ASARCO* and *Woolworth*. *See Container Corp., supra,* 463 U.S. at 167 (Court notes with apparent approval the existence of variations in the unitary business concept that are "logically consistent").

C. *The Court Should Identify The State Tax System Or Systems It Seeks To Uphold Regarding The Apportionability Of Intangible Income.*

The errors of *ASARCO* and *Woolworth* would have been avoided, if the Court had identified precisely the state tax system or systems it was upholding with

respect to the division of intangible income among the States. The Court's third question indicates that the Court may now be prepared to make this identification. State tax administrators are particularly pleased to see the third question of the Court, because it has the potential to draw taxpayers out of the abstract world of arguing what constitutes a unitary business to identifying precisely where the intangible income should be taxed, if at all. Justice O'Connor clearly wanted the Court to identify the state tax system that should govern the apportionability of intangible income. *ASARCO, supra,* 458 U.S. at 344-49 (dissenting opinion). The Court, having asked the third question, is unlikely to commit the error it did in *ASARCO* and *Woolworth*.

II. *ASARCO* AND *WOOLWORTH* SHOULD BE OVERRULED RETROACTIVELY, BECAUSE UNDER *CHEVRON OIL CO.* v. *HUSON*, 404 U.S. 97 (1971), SUCH A HOLDING WOULD NOT ESTABLISH A NEW PRINCIPLE OF LAW AND *ASARCO* AND *WOOLWORTH* DID NOT ESTABLISH ANY DEFENSIBLE CONSTITUTIONAL PRINCIPLE UPON WHICH TAXPAYERS COULD HAVE EQUITABLY RELIED.

Others filing briefs in support of Respondent in this supplemental proceeding have adequately discussed the Court's second question. *Amicus* supports the adoption of the test in *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971), even in cases of the Court involving possible expansion of state tax authority. *But cf. McKesson Corp.*

v. *Div. of Alcoholic Beverages & Tobacco,* 110 S.Ct. 2238, 2252 n.23 (1990). The overruling of *ASARCO* and *Woolworth* should be fully retroactive in view of the inherent weakness of *ASARCO* and *Woolworth* as precedent, the highly factual nature of the Court's rulings, and the severe restrictions placed on their applicability following *Container Corp., supra.* An overruling would not establish a new principle of law. Neither case established any defensible constitutional principle upon which taxpayers could have equitably relied. An overruling removes dead underbrush.

III. THE CONSTITUTION PERMITS STATES TO APPORTION INCOME IN ACCORDANCE WITH THE FORMAL IDENTITY OF SEPARATELY ORGANIZED BUSINESS ENTITIES AS WELL AS TO EMPLOY OTHER THEMES OF A UNITARY BUSINESS INVOLVING THE USE OF COMBINED REPORTING AND/OR DISTINCT BUSINESS REPORTING.

A. *The Constitution Permits States To Fashion Logically Consistent Approaches To Dividing The Income Of A Multistate Business That Do Not Produce Arbitrary And Unfair Results.*

The Due Process and Commerce Clauses describe the constitutional outer limits of a state's power to tax income earned by a business operating within the several States (whether derived from the sale of goods and services or from the ownership of intangibles).

These principles, as set forth by this Court in *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977), and *Container Corp., supra*, set forth a four prong test.[8] And Allied-Signal has made clear that its complaint in this case is with the first prong based upon its readings of *ASARCO* and *Woolworth*.

However, as vindicators of the constitutional protection against extra-territorial state action, *ASARCO* and *Woolworth* strangely intrude on state tax sovereignty where the contesting taxpayers were admittedly doing substantive and purposive business in the taxing States. *See Nat'l Geographic Society* v. *California Bd. of Equalization*, 430 U.S. 551, 561 (1977) (use tax collection responsibility is premised on unrelated in-state activity); *Miller Bros. Co.* v. *Maryland*, 347 U.S. 340, 344-45 (1954) (some definite link, some minimum connection between the state and the person, property, *or* transaction supports jurisdiction); *Internat'l Shoe Co.* v. *Washington*, 326 U.S. 310, 316 (1945) (concern is traditional notions of fair play and substantial justice).

Fortunately, with respect to claims of extra-territorial taxation, taxpayers have the burden to establish

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[8]The four prong test requires any state income tax to be imposed on those doing interstate business to be (i) imposed upon a taxpayer or transaction with which the state has a sufficient nexus or minimum connection; (ii) fairly apportioned to the state in terms of the tax imposed meeting the internal and external consistency tests; (iii) nondiscriminatory against interstate commerce; and (iv) fairly related to the services provided by the state.

that the resulting tax was arbitrary and unconstitutional. *Container Corp., supra,* 463 U.S. at 175, citing *Norton Co.* v. *Dept. of Revenue,* 340 U.S. 534 (1951). A failure of such proof leaves the States free to fashion any logically consistent solution to solving the problem of dividing the income of a multistate business that has nexus with the taxing State. Variants of the unitary business principle are permitted. *Container Corp., supra,* 463 U.S. at 167-69, 178 n. 17; *Moorman Mfg. Co.* v. *Bair,* 437 U.S. 267, 279 (1978) (Constitution is neutral). The Due Process and Commerce Clauses do not mandate a judicially developed national state tax code, *id.*, 437 U.S. at 275, 279-80, because it would unjustifiably exclude the interests of all the States. *Id.* These considerations have led the Court to defer to Congress.[9]

Under these principles the Court may uphold the system of taxation employed by New Jersey as a constitutionally permitted variant of the unitary business concept. Approval of the New Jersey system would not affect other States' use of the unitary business concept to support combined reporting and/or the distinct business reporting that may break apart affiliated business segments.[10] Thus, a taxpayer has no right to choose

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[9]Impermissible discrimination against protected commerce (*e.g.*, burdensome multiple taxation) may be regulated without congressional legislation. *Mobil Oil, supra,* 445 U.S. at 447. Allied-Signal does not claim impermissible discrimination, however.

[10]Combined reporting and distinct business reporting are noted by the Court in *U.S. Steel Corp.* v. *Multistate Tax Comm'n,* 434 U.S. 452, 473 n.25 (1978), and *Container Corp., supra,* 463 U.S. at 167 and

which of the constitutionally permissible systems of taxation it wants applied in any particular State.

B. *New Jersey's System Of Taxation That Fully Apportions The Income Of Separately Organized Business Entities With Nexus In The Taxing State Provides Fundamental Fairness.*

New Jersey's system of taxation can be legitimately described as a logically consistent variant of the unitary business principle. *Container Corp.*, *supra*, 463 U.S. at 168 n.5. Thus, New Jersey in effect statutorily defines a unitary business as the entire business conducted by each separate business entity. If the entity has nexus with New Jersey, New Jersey apportions the entity's entire income. This *de facto* statutory definition of the unitary business provides taxpayers with fundamental fairness.

New Jersey's system of taxation recognizes that all the property of a single business entity is presumably being "held and used for the purposes of its business." *Adams Express Co.* v. *Ohio State Auditor*, 165 U.S. 194, 227 (1897). The statutory presumption is consistent with a reasonable assessment of economic reality, not only because the record in this case has demonstrated that modern business operates on this premise, *e.g.*, *How Companies Should Use Their Cash*, THE NEW YORK TIMES Section 3, p. 2 (April 25, 1982), Ex. D-19 to Depo. of

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167 n. 2.

Agee (J.A. 134), but also because the very inclusion of property within a single business entity necessarily presupposes a management that operates for the benefit of the entire integrated whole of the corporation. Management of the single business entity, which by definition is central, in all probability is grounded in operational expertise and *overall* operational strategy. *Container Corp., supra,* 463 U.S. at 180 n. 19. Thus, for example, where management within a single entity raises and allocates capital, it necessarily does so on the strength of, for the greater good of, and to the aggregate liability of the entire entity. A non-arm's length flow of capital resources among the segments of the single entity is obvious. *See Container Corp., supra,* 463 U.S. at 180 n.19.

While different segments within a single entity might be found in a rare circumstance to operate distinctly, this theoretical possibility does not preclude New Jersey's logically and consistently applied concept of full apportionment. New Jersey accepts both the good and the bad of its choice to recognize the separate identity of different business entities. One good aspect, benefitting both taxpayer and state tax administrator, is the avoidance of expensive and complicated factual inquiries. One bad aspect is that New Jersey forgoes complaint about the apportionment of losses or deductions into New Jersey that occur within the confines of a single entity. (Bendix directly benefitted from this rule by deducting against its preapportionment New Jersey tax base the interest expense of its debt financed acqui-

sition of ASARCO. Tr. Oral Arg. 46.) Further, New Jersey does not employ combined reporting to "apportion in" income of business entities lacking nexus which are engaged in the same unitary business. Resp. Br. 13. In the face of these *consistent* concepts, it would be *inconsistent* to require New Jersey to accept a single business entity's attempt to disassociate a segment of its income from the taxing State.

In addition, the fairness of the New Jersey system clearly is underscored when one realizes that all Allied-Signal's predecessor-in-interest apparently had to do to avoid taxation of the disputed gain in this case was to move the ASARCO interest out into a separately organized corporation that had no nexus with New Jersey. Taxpayers undoubtedly are becoming increasingly aware of the state tax manipulation potential of these kind of business reorganizations. Rosen, *Use of Delaware Holding Company to Save State Income Taxes,* 20 TAX ADVISOR 180 (March 1989); Stevens, *Delaware Sub. Can Still Reduce Tax But More Planning Needed,* 2 J. MULTISTATE TAX'N 4 (March/April 1982).

C. *The Constitution Additionally Permits Other States To Employ The Unitary Business Principle That Is More Expansive Than What Is Suggested In* ASARCO *and* Woolworth *To Support Combined Reporting And/Or Distinct Business Reporting.*

Many States eschew New Jersey's single entity system of taxation in favor of using the unitary business

principle to support combined reporting and distinct business reporting. These alternative reporting methods avoid manipulative tax planning that has no economic substance.[11] These possibilities support the Court's view that the form in which a segment of the unitary business is being held does not limit the scope of the unitary business. *Mobil Oil, supra,* 445 U.S. at 440.

As has been previously noted, *see* pp. 6-9, *supra,* the appropriate test for determining the scope of a unitary business is to define which of the different business segments within an enterprise are integrated, *i.e.,* "refereed" by management that is organized or poised to ensure that the different segments of an enterprise are operated for the benefit of the whole and not individually. Any enterprise so structured, is likely to

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[11]The potential for organizational restructuring is increased significantly by the federal tax conformity of state corporate income tax systems. *Conformity to Federal Rules for Determining Taxable Income and Income Tax Rates,* 1 1992 MULTISTATE CORPORATE TAX GUIDE I-53 to I-61 (1992); J. Hellerstein, STATE TAXATION: CORPORATE INCOME AND FRANCHISE TAXES ¶ 7.2 p.266, (1983). Numerous non-recognition provisions exist in the federal tax code without regard to their effect on state taxation.

Two simple examples illustrate the point. Assume that the taxing State in *Butler Bros., supra,* employed separate entity taxation similar to what New Jersey employs. In the absence of combined reporting, a taxpayer could avoid the results achieved in *Butler Bros.* by the single expedient of separately incorporating the several warehouse operations and ensuring that the operations outside the taxing State developed no nexus with that State. Similarly, a business enterprise desiring to apportion losses or deductions into the taxing State could ensure that result in a single entity state by moving the losses or deductions into the single corporation that had nexus with that State.

achieve "the subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." *Container Corp., supra,* 463 U.S. at 164-65. And if the unitary business principle is to be administrable in the context of state taxation of multijurisdictional commerce, "the potentials of the relationship" should be seen as supporting a unitary business finding. Requiring proof of actual transfers of value is inappropriate where the risk being guarded against is the nontaxation of income attributable to "a sharing or exchange of value not capable of precise identification or measurement."[12] *Container Corp., supra,* 463 U.S. at 166. *See* pp. 6-9, *supra.*

Application of these principles to a *single* entity, even in states employing combined reporting and distinct business reporting, is likely to support a unitary finding for all sets of activities being conducted within the entity. *See* pp. 21-22, *supra,* which sets forth with respect to the single entity states why this is so based upon economic reality of the circumstances. *Amicus* thus concludes that application of the test proposed in

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[12]This test would eliminate the attempts of taxpayers to segregate so-called excess cash into investment operations that they claim thereafter no longer relate to the operational aspects of their business. *E.g., American Home Products Corp.* v. *Director, Div. of Taxation,* 11 N.J. Tax 287 (Tax Ct. 1990), *app. pending,* N.J. Super. Ct., No. A-4316-90T3. Retention of the cash impeaches the contention. *Cf.,* 26 U.S.C. §531 (1988). Also, no one seriously believes cash managers are allowed to make investment decisions without an eye on the entire enterprise, including the potential needs of the enterprise's separate, operational segments.

a state employing the unitary business concept to support combined reporting would not change the results here. The ownership (*i.e.*, acquisition, management, and disposition) of the ASARCO interest was part of the unitary business of Bendix, part of which was conducted in New Jersey. *See* Br. *Am. Cr.* Multistate Tax Comm'n 13-20.

Notwithstanding these observations, the Court should clearly state that both taxpayers and state tax administrators are free to establish in combined reporting States that different operations within a single business entity are not integrated into a unitary business. While the possibility of this circumstance occurring is low, the logical consistency prescribes the retention of the possibility and indeed stands guard against abusive use of a flat rule that all activities of a single business entity are unitary within a State employing combined reporting.[13] *See* n.11, *supra*.

D. *Any System of State Taxation Allied-Signal Would Propose For Taxing Intangible Income Is Not Constitutionally Required.*

It is not clear what system of state taxation Allied-Signal seeks to uphold. Justice O'Connor's prior identification and refutation of the three possibilities,

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[13]New Jersey with its system of single entity reporting has decided at this stage that it is willing to live with the potential of abuse where at least the form of business coincides with economic substance.

ASARCO, supra, 458 U.S. at 344-49 (dissenting opinion), demonstrates the debilitating impact any of three would have on State taxation. This debilitation disqualifies the three from being considered constitutionally required solutions in a case involving no claims of impermissible discrimination. Before concluding, however, *Amicus* will respond specifically to any contention that States are constitutionally required to adopt a system of allocation based upon the concept of domicile.[14]

There is no support for allocation of income based upon domicile as a constitutionally required system. First, the system is based upon an absolute fiction insofar as it pertains to intangibles. As a result, the Court has not recognized the property tax concept upon which this system is based as being constitutionally required in state income taxation. *Mobil Oil, supra,* 445 U.S. at 443-46.

Second, there is little to indicate today that duplicative state taxation, the goal sought to be resolved in property taxation, is a pressing problem of federalism with respect to corporate income taxation. *See* Br. *Am. Cr.* Multistate Tax Comm'n 24 n.8 (cont'd). Indeed, the Constitution flexibly allows for the possibility of duplicative income taxation, because of the inherent problems

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[14]*Amicus* focuses on this possibility, because it appears as Allied-Signal's most likely candidate. The separate investment *business* possibility does not seem a likely candidate in view of Allied-Signal's hard line position that the ASARCO gain did not arise from operations. *See, e.g.,* Pet. Br. 29.

in actually resolving duplicative taxation. *Container Corp., supra,* 463 U.S. at 188, 192-93.

Third, business does not perceive the income it realizes from intangibles as being qualitatively different from income realized from selling its product. *How Companies Should Use Their Cash, supra.* The States should have the option to treat all income from a business as apportionable, as opposed to allocable, income. The *state* law distinction of business/nonbusiness income of the Uniform Division of Income for Tax Purposes Act §§ 1(a) and (e), 7A UNIFORM LAW ANNOTATED 331, 336-37 (1985) ("UDITPA"), is not constitutionally required.[15]

Fourth, adoption of allocation, as opposed to apportionment, as the constitutional limit proceeds backwards.[16] What little remains of state income tax

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[15]To say that the distinction is not constitutionally required is not the same thing as saying it would be unconstitutional to provide for the distinction. States have flexibility in this area. *See* pp. 18-21, *supra.*

[16]The deficiency of allocation rules is easily demonstrated. Assume a corporation commercially domiciled in State A holds a parcel of real estate in State B for purely passive investment purposes. (The assumption is that the parcel of real estate is not related to any ongoing business being conducted by the corporation.) Assume further that State B that attributes gain for this kind of passive investment real estate to the State where the property is located. Assume also that State B attributes gain arising from the sale of intangibles, such as passive investment corporate stock, to the State of commercial domicile of the owner/seller of that stock. By converting the real estate into stock, which can be accomplished tax-free under state tax codes conforming to the federal tax code, a taxpayer can shift where the gain realized from

rules that allocate, as opposed to apportion, income can be seen as residual holdovers of an earlier era when constitutional concepts impeded the States from raising their fair share of income from interstate business.[17] It seems a reasonable probability that given sufficient indication from the Court, the States may well abandon the use of residual domiciliary based allocation rules as a state law concept in the corporate income tax area. This abandonment would in all probability include even UDITPA's limited business and nonbusiness income distinction. In the meantime, state tax systems typically authorize taxpayers to seek relief from specific division of income rules where their application does not fairly represent the extent of the taxpayer's activity in the taxing State. *E.g.*, UDITPA, *supra*, §18. This common escape valve provides a method to address rare instances of burdensome, duplicative state taxation.

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the sale of the passive investment real estate will be recognized.

Given this and other inherent limitations of specific allocation, J. Hellerstein, STATE TAXATION: CORPORATE INCOME AND FRANCHISE TAXES ¶9.2 p. 481 (1983), it is not surprising that States would move away from it. Following *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 459-62 (1959), that answered unequivocally for the first time that nondomiciliary states could impose a nondiscriminatory income tax on an exclusively interstate business, States have embraced apportionment. *Compare State Taxation of Interstate Commerce*, H.R. REP. NO. 1480, 88TH CONG., 2D SESS., PT. II, 197-217 (June 15, 1964) (describing then existing allocation practices of the States) *with* 1 1990 MULTISTATE CORP. INCOME TAX GUIDE ¶167 (CCH 1991).

[17] *See* J. Hellerstein, STATE TAXATION: CORPORATE INCOME AND FRANCHISE TAXES ¶9.4 pp. 488-91 (1983).

CONCLUSION

For the foregoing reasons, *Amicus* respectfully requests the Court to affirm the decision below and in doing so should recognize the rights of the States to employ a logically consistent concept of a unitary business that permits both the single entity approach and the combined reporting and distinct business reporting approach.

Respectfully submitted,

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